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In The

Supreme Court of the United States

October Term, 1995

PROMETHEUS FUNDING CORP., etc., et al.,

Petitioners,

vs.

MERCHANTS HOME DELIVERY SERVICES, INC.,

Respondent.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

BRIEF OF FARMERS INSURANCE EXCHANGE AND STATE FARM FIRE AND CASUALTY COMPANY AS AMICI CURIAE IN SUPPORT OF PETITIONERS

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BRIEF OF FARMERS INSURANCE EXCHANGE AND STATE FARM FIRE AND CASUALTY COMPANY AS AMICI CURIAE IN SUPPORT OF PETITIONERS

INTEREST OF THE AMICI CURIAE

Farmers Insurance Exchange ("Farmers") and State Farm Fire and Casualty Company ("State Farm") are insurance carriers conducting business in California and elsewhere. They have a vital interest in the issues presented by the pending petition for writ of certiorari. The Ninth Circuit's decision in this case threatens to expose Farmers, State Farm and all other insurers to greatly expanded liability under federal laws, liability to which insurers have not previously been exposed. Farmers and State Farm believe such expanded liability would translate into increased insurance costs, exacerbating already severe problems of insurance scarcity and unaffordability

to the serious detriment of both insurers and the insurance-buying public.

The parties have consented to the filing of amicus curiae briefs supporting and opposing the petition for writ of certiorari. Letters documenting the parties' consent are being submitted with this brief.

SUMMARY OF ARGUMENT

Section 2(a) of the McCarran-Ferguson Act ("the McCarran Act" or "the Act"), 15 U.S.C.A. § 1012(a) (West 1976), provides that the business of insurance shall be subject to the laws of the states relating to the regulation of that business. Section 2(b) of the Act then declares, in pertinent part: "No Act of Congress shall be construed to *invalidate, impair, or supersede* any law enacted by any State for the purpose of regulating the business of insurance . . . unless such Act specifically relates to the business of insurance." *Id.* § 1012(b) (emphasis added).

The Ninth Circuit has construed section 2(b) of the McCarran Act to permit a private action against an insurance broker under the Racketeer Influenced and Corrupt Organizations Act ("RICO"), 18 U.S.C.A. §§ 1961-1968 (West 1984 & Supp. 1995), based on conduct (overcharging for premiums) that is already strictly regulated by California's insurance laws. The Ninth Circuit held that, absent a *direct conflict*, a federal statute does not "invalidate, impair, or supersede" a state statute, even though the federal statute injects into the state scheme a new remedy the state legislature chose not to make available.

The Ninth Circuit's narrow reading of the McCarran Act is unfaithful to its language, which neither requires nor contemplates a direct conflict between state and federal law. Congress intended to leave the states with virtually plenary power to regulate the business of insurance unimpeded by general federal legislation not specifically targeted at that business. To effectuate this intent, Congress chose the broad phrase "invalidate,

impair, or supersede." Numerous courts have held a federal statute "impairs" state law even though not in direct conflict with such law if, as here, the federal statute introduces remedies not available under state law. The sole authority on which the Ninth Circuit relied, a 1992 decision by the Seventh Circuit, is unpersuasive because that court started from the *premise* that the McCarran Act requires a direct conflict between state and federal law yet cited no authority for the proposition and failed to explain how it derived such a rule from the text of the Act. One district court recently criticized the decisions of both the Seventh and Ninth Circuits on this and other grounds.

The Ninth Circuit's erroneous reading of the McCarran Act will seriously disrupt the insurance markets in California and possibly elsewhere. The California courts have warned that permitting a private action against insurers under RICO based on conduct that is already comprehensively regulated by state law will seriously upset the state regulatory scheme. Heedless of this warning, the Ninth Circuit has construed the McCarran Act virtually out of existence in RICO cases. Henceforth, not only overcharging for premiums but virtually any insurer misdeed regulated by state law may support a RICO claim. To subject insurers to RICO's threat of treble damages and attorney fees, threats they do not face under state law, cannot help but disrupt the insurance market by increasing the cost of insurance. Meritorious or not, the mere presence of a RICO claim in a suit against an insurer will have an extortionary effect and will coerce settlement of many claims insurers otherwise would have successfully defended. In this era of insurance scarcity and unaffordability, insurers and the insurance-buying public are profoundly disserved by a judicial decision that unjustifiably subjects insurers to greatly expanded liability and costs.

ARGUMENT

THIS COURT SHOULD GRANT THE PETITION FOR WRIT OF CERTIORARI BECAUSE THE NINTH CIRCUIT'S NARROW READING OF THE MCCARRAN-FERGUSON ACT IS ERRONEOUS AND DISRUPTIVE.

A. The Ninth Circuit's Reading Of The Act Is Unfaithful To Its Language, Which Does Not Require Or Contemplate A Direct Conflict Between State And Federal Law.

Prior to this Court's decision in *United States v. South-Eastern Underwriters Ass'n*, 322 U.S. 533 (1944), "it had been assumed that '[i]ssuing a policy of insurance is not a transaction of commerce,' . . . subject to federal regulation. Accordingly, 'the States enjoyed a virtually exclusive domain over the insurance industry.' " *U.S. Dep't of Treasury v. Fabe*, 113 S. Ct. 2202, 2207 (1993) (citation omitted). In *South-Eastern Underwriters*, the Court held the insurance business was indeed engaged in interstate commerce and was therefore subject to federal regulation. "This result, naturally, was widely perceived as a threat to state power to tax and regulate the insurance industry. To allay those fears, Congress moved quickly to restore the supremacy of the States in the realm of insurance regulation. It enacted the McCarran-Ferguson Act within a year of the decision in *South-Eastern Underwriters*." *Id.*

"[T]he primary purpose of the McCarran-Ferguson Act was to preserve state regulation of the activities of insurance companies, as it existed before the *South-Eastern Underwriters* case." *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205, 218 n.18 (1979) (emphasis omitted). Congress declared "that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States." 15 U.S.C.A. § 1011 (West 1976).

To effectuate this policy, the McCarran Act provides:

> (a) The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.
>
> (b) No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance . . . unless such Act specifically relates to the business of insurance . . . .

Id. § 1012.

Thus, the McCarran Act bars application of a federal statute to the business of insurance where: (1) the statute does not specifically relate to the business of insurance; (2) the acts challenged under the statute constitute the business of insurance; (3) the state has enacted a law or laws regulating the challenged acts; and (4) the state law would be superseded, impaired or invalidated by the application of the federal statute. *Cochran v. Paco, Inc.*, 606 F.2d 460, 464 (5th Cir. 1979).

The parties here do not dispute that the first and third prongs of this four-part test were satisfied with respect to all the practices challenged by plaintiff's complaint. *Merchants Home Delivery Serv., Inc. v. Frank B. Hall & Co.*, 50 F.3d 1486, 1489 (9th Cir. 1995). Moreover, the court of appeals had no difficulty holding the second prong was satisfied with respect to the defendants' alleged practice of "[o]vercharging for premiums on actual [insurance] policies." *Id.* at 1490. The court rightly viewed this type of transaction to be "at the core of the 'business of insurance.' " *Id.*

Thus, whether the McCarran Act permitted plaintiff to maintain an action under RICO challenging defendants' alleged practice of overcharging for existing policies turned on the fourth prong of the four-part test – whether application of RICO would "invalidate, impair, or supersede" California's comprehensive regulatory scheme.

In answering this question, the Ninth Circuit adopted an exceedingly narrow construction of the language of the McCarran Act. The court held that, absent a *direct conflict*, a federal statute does not "invalidate, impair, or supersede" a state statute even though the federal statute injects into the state scheme new remedies the state legislature chose not to make available. In the court's view, "the application of a federal statute prohibiting acts which are also prohibited under a state's insurance laws does not 'invalidate, impair, or supersede' the state's laws under § 2(b) of the McCarran-Ferguson Act." *Id.* at 1492. The court concluded: "Under this rule, § 2(b) allows the application of RICO to the present facts. Hall concedes . . . that California law prohibits the acts alleged by Merchants. As RICO prohibits these same acts, there is no conflict; RICO does not invalidate, impair, or supersede California law in this context." *Id.*

The Ninth Circuit's reading of the McCarran Act is flawed as a matter of statutory construction. This Court has explained "the starting point in a case involving construction of the McCarran-Ferguson Act, like the starting point in any case involving the meaning of a statute, is the language of the statute itself." *Group Life & Health Ins. Co.*, 440 U.S. at 210. The Act provides: "No Act of Congress shall be construed to *invalidate, impair, or supersede* any law enacted by any State for the purpose of regulating the business of insurance . . . unless such Act specifically relates to the business of insurance: . . . . " 15 U.S.C.A. § 1012(b) (emphasis added).

"The words 'invalidate, impair and supersede' are not defined in the McCarran-Ferguson Act[,]" so they "must be given their ordinary meaning unless another meaning is dictated by the context in which they are used." *Ambrose v. Blue Cross & Blue Shield of Virginia, Inc.*, 891 F. Supp. 1153, 1165 (E.D. Va. 1995). Context dictates no extraordinary meaning in this case.

" 'Invalidate' means to 'weaken or make valueless' or to discredit. It is a synonym for nullify. 'Impair' means to

'make worse . . . diminish in quantity, value, excellence or strength . . . do harm to.' " *Id.* (quoting Webster's Third New International Dictionary 1131, 1188 (1986) (alteration in original)); *see Brownell v. State Farm Mut. Ins. Co.*, 757 F. Supp. 526, 536 n.13 (E.D. Pa. 1991) (citing Webster's Ninth New Collegiate Dictionary 603 (1986) and Webster's Collegiate Thesaurus 418 (1976)) (As used in the McCarran Act, " '[i]mpair' means to damage, injure, diminish, prejudice, undermine or weaken."). " 'Supersede' means to 'make obsolete, inferior, or outmoded . . . to make void . . . to make superfluous or unnecessary.' " *Ambrose*, 891 F. Supp. at 1165 (quoting Webster's Third New International Dictionary, *supra*, at 2295).

Given these definitions, it is clear a federal statute can "invalidate, impair and supersede" state regulations without directly conflicting with them. Where a state has enacted a comprehensive, detailed statutory and regulatory scheme governing the business of insurance, including a carefully crafted system of enforcement and penalties for unfair or deceptive practices, to allow a plaintiff to invoke a federal statute and seek a remedy not available under the state scheme is to diminish, undermine, weaken, and nullify the state's authority.

Had Congress intended the McCarran Act to receive the narrow reading the Ninth Circuit accorded it, Congress would have employed the word "conflict" rather than the phrase "invalidate, impair, or supersede." Congress chose the latter, more sweeping phrase because Congress intended the states to have virtually plenary power to regulate the business of insurance unimpeded by general federal legislation not specifically targeted at that business. (*See* Petition for Writ of Certiorari at 8-10.)

B. The Ninth Circuit's Reading Of The Act Is Contrary To Numerous Cases.

Consistent with the plain language of the McCarran Act, numerous courts have held the Act bars a RICO

claim based on insurance practices regulated by state law where recovery under RICO would undermine, disrupt, upset or simply alter the remedial scheme established by the state legislature. These courts do not read the McCarran Act to require a direct conflict between state and federal law.

For example, in *Senich v. Transamerica Premier Insurance Co.*, 766 F. Supp. 339 (W.D. Pa. 1990), the plaintiffs filed an action against certain insurers under RICO alleging, as plaintiff did here, "that their premiums were excessive." *Id.* at 341. Noting that Pennsylvania had enacted "comprehensive laws which regulate the business of insurance," *id.* at 340, including laws governing the fixing of premiums, the court held the McCarran Act barred plaintiffs' RICO claim:

> Pennsylvania has enacted the Casualty and Surety Rate Regulation Act ("Rate Act"), . . . which provides that '[r]ates shall not be excessive' and requires insurance companies to gain approval from the Pennsylvania Department of Insurance for their proposed premium rates. . . . In addition, the Rate Act provides for an administrative procedure whereby persons 'aggrieved with respect to any filing which is in effect' may file complaints with the Insurance Commissioner and have a hearing. . . . *[S]ince Pennsylvania insurance law extensively regulates the fixing of such rates, Plaintiffs' RICO claims, under which they characterize their premium grievances, would 'invalidate, impair, or super[s]ede' the state's laws.*

Id. at 341 (emphasis added) (citations omitted). The court observed that, "while alleging RICO violations, the plaintiffs are attempting to reach the defendants' underlying insurance practices which are subject to the comprehensive Pennsylvania regulatory scheme." *Id.* at 342. The McCarran Act barred such an attempt.

Likewise, in *LeDuc v. Kentucky Central Life Insurance Co.*, 814 F. Supp. 820 (N.D. Cal. 1992), certain agents for a

life insurer filed actions against the insurer under RICO alleging the insurer "engaged in a pattern of making false and fraudulent representations to its agents, and to members of the general public in order to perpetrate a scheme that would allow [the insurer] to distort its financial condition so that its agents would be induced to sell, and members of the general public would be induced to purchase," the insurer's policies and annuity investments. *Id.* at 827. The court granted the insurer's motion to dismiss the RICO claim. To permit plaintiffs to proceed under RICO, the court reasoned, would "impair" and "supersede" California's comprehensive statutory and regulatory scheme governing unfair and deceptive insurance practices by introducing new remedies not available under state law:

> The application of a federal statute to matters regulated by state insurance law would arguably impair state law. For instance, RICO violations include treble damages and attorneys' fees. The California legislature has not provided such remedies for misrepresentations regarding an insurance company's financial condition. In fact, applying RICO would nullify the state's determination of the appropriate remedies for certain conduct and would supersede remedies and regulatory supervision provided by California law.

Id. at 829. Like the *Senich* court, the *LeDuc* court did not require a showing that RICO directly conflicted with any state law. The McCarran Act applied because "California's comprehensive regulatory supervision of insurers' financial conditions would be *undermined and disrupted* if agents and policyholders were permitted to assert federal RICO claims based upon allegations of financial nondisclosure." *Id.* (emphasis added).

To the same effect is *Wexco Inc. v. IMC, Inc.*, 820 F. Supp. 194 (M.D. Pa. 1993). The court ruled the McCarran Act barred plaintiffs from proceeding under RICO based on insurance practices regulated by state law, not because

RICO *conflicted* with state law but because RICO's remedial scheme *differed* from, and thus disrupted, the comprehensive scheme the state legislature had enacted:

> [T]he Pennsylvania legislature chose to have [the Pennsylvania Unfair Insurance Practices Act] and other Pennsylvania insurance regulatory law enforced solely by the Commonwealth's Insurance Commissioner. There is no private cause of action available for violation of the PUIPA or any Pennsylvania insurance regulations. . . . While Pennsylvania courts have held that common law causes of action available prior to the enactment of the PUIPA, such as common law fraud and deceit actions, continue to be viable options for aggrieved insureds, . . . such common law actions do not reward plaintiffs with the treble damages, costs and attorney fees mandated by RICO. . . . The availability of a federal private action under RICO would not merely nullify the state's chosen regulatory remedies for insurance entity misconduct. Rather, this court believes that the availability of a federal private remedy which would reward successful business plaintiffs, such as the captioned parties, with treble damages, costs and attorney fees cannot help but upset the balance of relationships between insurance entities and insureds which are established and regulated by PUIPA and the other state laws . . . .

Id. at 203-04 (footnotes and citations omitted).

The court followed *LeDuc* and *Wexco* in *Forsyth v. Humana, Inc.*, 827 F. Supp. 1498 (D. Nev. 1993). The court reasoned that, because the state did not regulate the challenged unfair insurance practices with "the same harsh penalties which would be available under RICO[,]" *id.* at 1521, application of RICO would impair state law: "For this Court to allow Plaintiffs to pursue the harsher

RICO penalties for behavior which the Nevada Legislature apparently did not deem worthy of such penalties, would be tantamount to allowing Congress to intercede in an area expressly left to the states under the McCarran-Ferguson Act." *Id.* at 1521-22.

Yet again, in *Everson v. Blue Cross & Blue Shield*, No. 93CV7534, 1994 WL 675200 (N.D. Ohio June 15, 1994), the court held RICO's provision of treble damages and attorney fees would impair a state regulatory scheme which afforded no private right of action: "The Ohio legislature has chosen to have Ohio insurance regulatory law enforced solely by the Superintendent of Insurance. There is no private cause of action . . . . Thus, application of RICO would impair the enforcement of Ohio insurance law." *Id.* at *12 (citation omitted). The *Everson* court rejected the argument that RICO cannot be said to impair state law when that law affords a right of action for fraud: "Plaintiffs argue . . . that because private actions for common law fraud exist in addition to actions under § 3901.21 [regulating unfair and deceptive acts of insurance companies], a fraud-based RICO claim does not impair Ohio law. However, common law fraud actions 'do not reward plaintiffs with the treble damages, costs, and attorney fees mandated by RICO.' " *Id.*

Most recently, the district court for the Eastern District of Virginia likewise held that to permit private actions under RICO against insurers "would invalidate and impair the regulation sought to be accomplished" by Virginia's Unfair Trade Practices Act. *Ambrose*, 891 F. Supp. at 1165. The court explained that the threat of private litigation under RICO would undermine the state regulatory scheme by inhibiting insurers from settling disputes in the administrative setting:

> Most aggrieved insureds would opt for the prospect of treble damages [under RICO] rather than participate in remedial measures structured by [Virginia's State Corporation Commission, or "SCC"]. This would make insurers less willing to agree with the SCC to settle disputes over

> alleged violations for fear of compromising their positions in pending or threatened RICO litigation. The ability to act promptly and to secure for insureds settlements is central to the state's ability to protect insureds and to regulate the insured-insurer relationship.

Id. For these reasons, "[t]he prospect of treble damages and attorneys fees would weaken, diminish and do serious injury to, if not nullify, the sections of [the Unfair Trade Practices Act], and the enforcement mechanisms which protect and regulate that [insured-insurer] relationship." *Id.*

The *Ambrose* court further explained how, if private actions under RICO were available, RICO would supersede Virginia's laws:

> Because RICO provides for a private cause of action and treble damages, and because these provisions of RICO differ dramatically from the way in which Virginia's insurance code addresses the same conduct, RICO would in effect replace [the Unfair Trade Practices Act] as the principal means by which to remedy such conduct. It would convert a system of public redress into a system of private redress. The forum for redress would shift from the SCC to the federal courts.

Id.; *accord Richhart v. Metropolitan Life Ins. Co.*, Civ. A. No. 89-1725, 1990 WL 39268, at *3 (E.D. Pa. Mar. 30, 1990) (rejecting argument that RICO claim was merely "supplemental to the existing state regulatory scheme").

The parties here do not dispute that California "has enacted comprehensive legislation expressly designed to regulate the business of insurance," *American Int'l Group, Inc. v. Superior Court*, 285 Cal. Rptr. 765, 774 (Cal. Ct. App. 1991), *cert. denied*, 504 U.S. 911 (1992), *see* Cal. Ins. Code §§ 790-790.10 (West 1993 & Supp. 1995), including the practices of which respondent complained. *See Merchants Home Delivery Serv., Inc.*, 50 F.3d at 1489 & n.1.

Indeed, California's Unfair Practices Act was enacted specifically to invoke the protection of the McCarran Act. It was designed "to regulate trade practices in the business of insurance in accordance with the intent of Congress as expressed in the [McCarran Act] . . . by defining, or providing for the determination of, all such practices in this State which constitute . . . unfair or deceptive acts or practices and by prohibiting the trade practices so defined or determined." Cal. Ins. Code § 790 (West 1993).

The California legislature has charged the Commissioner of Insurance with the exclusive authority to enforce these laws; private actions for damages are not permitted. *Moradi-Shalal v. Fireman's Fund Ins. Cos.*, 758 P.2d 58, 65, 250 Cal. Rptr. 116, 123 (Cal. 1988); *Gordon v. Ford Motor Credit Co.*, 868 F. Supp. 1191, 1196 (N.D. Cal. 1992). For this reason, in addition to the court in *LeDuc* which is discussed above, at least two other courts have held the McCarran Act bars private actions under RICO based on practices that are regulated by California's comprehensive insurance law. *See Gordon*, 868 F. Supp. at 1196-97 (" 'California has enacted comprehensive legislation expressly designed to regulate the business of insurance.' . . . Investigatory and enforcement authority for violations of the Code have been delegated to the commissioner of insurance. . . . [G]iven California's extensive regulation of the insurance industry, this court concludes that application of RICO would impair, invalidate, and supersede the body of substantive laws which California has enacted to govern insurance practices in this state.") (citations omitted); *American Int'l Group, Inc.*, 285 Cal. Rptr. at 777 ("Allowance of a RICO action seeking civil damages (including treble damages and attorneys fees) for the very conduct which California has chosen to regulate administratively would subvert and subsume the existing statutory scheme. It would permit a civil damage

recovery where our Supreme Court has recently and explicitly held that none was intended.").[1]

In sum, the Ninth Circuit's reading of the Act cannot be squared with numerous well-reasoned decisions by other courts.

C. The Ninth Circuit's Reliance On *American Family Mutual* Was Misplaced. That Decision Was Poorly Reasoned And Has Been Justifiably Criticized.

The authority discussed above is compelling, yet the Ninth Circuit chose not to follow it. Instead, the court relied solely on the Seventh Circuit's decision in *NAACP v. American Family Mutual Insurance Co.*, 978 F.2d 287 (7th Cir. 1992), *cert. denied*, 113 S. Ct. 2335 (1993). The plaintiffs there filed an action against a property and casualty insurer alleging that the insurer practiced "redlining" and that the practice was a form of racial discrimination forbidden by the Fair Housing Act, 42 U.S.C.A. §§ 3601-3619 (West 1994). One of the issues before the

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[1] In *Moradi-Shalal*, 758 P.2d at 65, 250 Cal. Rptr. at 123, the California Supreme Court held California's Unfair Practices Act, Cal. Ins. Code § 790.03 (West 1993), affords no private right of action for damages against an insurer. The court grounded its decision on legislative intent, explaining section 790.03 was enacted to empower the Insurance Commissioner to police insurance company misconduct, not to create private rights of action. *Moradi-Shalal*, 758 P.2d at 65, 250 Cal. Rptr. at 123. In the Ninth Circuit, respondent's supporters dismissed the importance of *Moradi-Shalal*, noting the decision did not purport to limit common law causes of action against insurers. (Brief Of Amicus Curiae California Association Of Hospitals And Health Systems In Opposition To Appellees' Petition For Rehearing And Suggestion For Rehearing En Banc at 14-15.) However, at least two courts have rejected this very argument on the ground "common law actions do not reward plaintiffs with the treble damages, costs and attorney fees mandated by RICO." *Wexco Inc.*, 820 F. Supp. at 204; *accord Everson*, 1994 WL 675200 at *12.

court of appeals was whether the McCarran Act barred plaintiffs' claim. The court declared the insurer was required "to show that the Fair Housing Act conflicts with state law. Duplication is not conflict." *American Family Mutual*, 978 F.2d at 295. The court cited no authority for the proposition, nor did it explain how it derived such a rule from the text of the McCarran Act.

Viewing the McCarran Act as "a form of inverse preemption," *id.* at 296, the court stated "principles defining when state remedies *conflict with* (and so are preempted by) federal law are pertinent in deciding when federal rules 'invalidate, impair, or supersede' state rules." *Id.* (emphasis added). The court thus started from the premise that the McCarran Act requires a conflict between state and federal law, yet that was the very issue the court purported to decide.

The court proceeded to consider parallel state-federal regulations in various areas and concluded "state and federal rules that are substantively identical but differ in penalty do not conflict with or displace each other." *Id.* at 297. This conclusion begs the question, which is whether the McCarran Act requires that the federal statute "conflict with or displace" the state statute, or merely requires, as the many cases cited above have held, that the federal statute alter the remedial scheme established by the state.

In *Ambrose*, 891 F. Supp. 1153, the court provided a detailed and compelling critique of the Seventh Circuit's decision in *American Family Mutual* and the Ninth Circuit's decision in the present case. The *Ambrose* court rejected as "overly broad and inconsistent with the plain meaning of the language of Section 2(b)" the Seventh Circuit's unexamined premise and the Ninth Circuit's holding that "any federal statute which proscribes the same conduct as a state statute will never 'invalidate, impair or supersede' the state statute." *Id.* at 1166. The *Ambrose* court reasoned:

> First, the inquiry that the McCarran-Ferguson Act requires, whether federal law 'invalidate[s],

> impair[s], or supersede[s]' state law, does not lend itself to a blanket rule that certain types of inconsistencies can never satisfy that language. Rather, the language of Section 2(b) requires that a court look at the actual effect of the federal law on the specific state law. In this case, the court is persuaded that allowing claims under RICO will greatly impair the [State Corporation Commission's] ability to enforce Virginia's insurance code and, specifically, to secure from insurers settlements that are in the interest of all insureds and in the public interest as well. The court also finds the disparity between the cause of action and remedy permitted by RICO and the enforcement mechanism and remedy permitted by Virginia's insurance code to be so great that the federal law would in fact supersede the state law. To ignore these conclusions in favor of a bright line rule that no federal law can 'invalidate, impair, or supersede' a state law so long as they prohibit the same acts is contrary to the purposes of the McCarran-Ferguson Act as well as to its plain language.

Id. at 1166-67.

The *Ambrose* court further rejected the proposition that "federal and state laws that prohibit the same conduct 'but differ in penalty do not conflict with or displace each other.' " *Id.* at 1167 (quoting *American Family Mutual*, 978 F.2d at 297). The court observed:

> Virtually any state statute includes more than a simple proscription of conduct. It includes the appropriate penalty for that conduct and the appropriate mechanism for enforcing the proscription. A state law that prohibits an act, punishes it with a specific range of fines, makes it the subject of remedial action, and vests enforcement in a state quasi-judicial entity cannot be said to be consistent with a federal law that prohibits the same act, permits treble damages,

> fees, and costs, and expressly creates a personal cause of action.

Id.

Finally, the *Ambrose* court criticized the "flawed, analytical model" common to *American Family Mutual* and the Ninth Circuit's decision here, namely, construing the "invalidate, impair, or supersede" clause of the McCarran Act under the rubric of " 'inverse preemption.' " *Id.* The court explained that, unlike preemption analysis which turns on "status, *i.e.*, supremacy of a body of [federal] law," *id.*, the McCarran Act turns on "the effect of the law, *i.e.*, whether an act of Congress 'invalidates, impairs or supersedes' certain kinds of state law." *Id.* "Forcing the McCarran-Ferguson Act analysis into the preemption model distorts the analysis required by the statutory test fixed by the McCarran-Ferguson Act." *Id.* The court observed the improper use of preemption analysis led the Seventh and Ninth Circuits mistakenly to interpret the Act "to require a showing of direct conflict between the state and federal law" and to "conclud[e] that state and federal law could co-exist even though the federal law provided a cause of action not provided under state law and remedies greater than those provided by state law." *Id.*

In short, the reasoning of *American Family Mutual*, which the Ninth Circuit adopted in this case, is seriously flawed. Neither decision provides analytically sound support for the proposition that the phrase "invalidate, impair, or supersede" in the McCarran Act requires a direct conflict between state and federal law. This Court should take the opportunity presented by this case to settle this important issue by holding the McCarran Act does not require a direct conflict. As we explain in our concluding section below, the Ninth Circuit's decision, if left uncorrected, threatens serious consequences.

D. The Ninth Circuit's Reading Of The Act Will Seriously Disrupt The Insurance Markets In California And Possibly Elsewhere.

Aside from its legal deficiencies, the Ninth Circuit's reading of the McCarran Act is flawed as a matter of public policy. The California courts have warned about "the significant impact which the availability of a civil RICO claim would have upon California litigation between insurers and insureds given existing California decisional and statutory law." *American Int'l Group, Inc.*, 285 Cal. Rptr. at 768. Heedless of this warning, the Ninth Circuit has construed the McCarran Act so narrowly that not only overcharging for premiums but virtually any alleged insurer misconduct regulated by state law may henceforth support a RICO claim.

The court of appeals seemingly embraced respondent's construction of the McCarran Act, under which "application of a federal law would be precluded only where the federal law expressly prohibited acts permitted by state law, or vice versa." *Merchants Home Delivery Serv., Inc.*, 50 F.3d at 1492. When will this test ever be satisfied? Plaintiffs do not sue insurers for acts *permitted* by state law; they sue for acts prohibited by state law. RICO will rarely if ever conflict with such state law and, as construed by the Ninth Circuit, the McCarran Act will rarely if ever apply. The court effectively construed the Act out of existence in RICO cases.

In recent years, California insurance markets have been plagued by problems of scarcity and unaffordability.[2] To subject insurers to RICO's threat of treble

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[2] In the automobile insurance market, California drivers already face the nation's highest costs. *Retroactive Liability: Beyond Superfund?*, Facts & Trends (RAND/Institute for Civil Justice, Santa Monica, Cal.), Spring 1993, at 3, 4. "Large numbers of uninsured motorists are opting out of the system altogether." *Auto Insurance Reform: Soon or Never?*, Facts & Trends (RAND/

damages and attorney fees, threats they do not face under state law, cannot help but further disrupt the markets by increasing the cost of insurance. Meritorious or not, the mere presence of a RICO claim in a suit against an insurer will prompt settlement of many claims insurers otherwise would have successfully defended. As Justice Marshall observed, private civil litigants, "lured by the prospect of treble damages and attorney's fees, have a strong incentive to invoke RICO's provisions whenever they can allege in good faith two instances of mail or wire fraud. Then the defendant, facing a tremendous financial exposure in addition to the threat of being labeled a 'racketeer,' will have a strong interest in settling the dispute." *Sedima, S. P. R. L. v. Imrex Co.*, 473 U.S. 479, 504 (1985) (Marshall, J., dissenting).

Amici curiae supporting respondent have denied that exposing insurers to liability for treble damages and attorney fees under RICO will disrupt California's insurance markets. They have argued: "California allows punitive damages to be awarded against insurance companies that engage in fraudulent or malicious conduct. There is no reason to believe RICO's civil remedies are more 'disruptive' to the market than open-ended exposure to punitive damages." (Brief Of Amicus Curiae California

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Institute for Civil Justice, Santa Monica, Cal.), Winter 1993, at 1. In the homeowners insurance market, California is experiencing a "full-blown . . . coverage crisis that is threatening to cripple the state's slowly recovering economy." *Editorial Comment, A Bold Response to California Crisis*, National Underwriter, Aug. 14, 1995, at 28. Battered by the January 1994 earthquake near Los Angeles and faced with a state requirement that they offer earthquake coverage as part of every homeowners policy, more than 90 percent of the insurers formerly offering such policies have simply abandoned the California market. *Quackenbush Quake Plan No Slam Dunk in Legislature*, National Underwriter, Sept. 4, 1995, at 2; *California Insurers Praise Quackenbush's Quake Plan*, National Underwriter, Aug. 7, 1995, at 5, 24.

Association Of Hospitals And Health Systems In Opposition To Appellees' Petition For Rehearing And Suggestion For Rehearing En Banc at 9 n.8 (citation omitted).)

This reasoning is flawed. Punitive damages are restricted to cases where the plaintiff proves by *"clear and convincing evidence"* that the defendant "has been guilty of oppression, fraud, or malice . . . . " Cal. Civ. Code § 3294(a) (West Supp. 1995) (emphasis added). Moreover, the amount of punitive damages must bear a reasonable relationship to the plaintiff's compensatory damages and cannot exceed the defendant's ability to pay in light of its financial condition. *See Adams v. Murakami*, 813 P.2d 1348, 1350-52, 284 Cal. Rptr. 318, 320-22 (Cal. 1991); *Neal v. Farmers Ins. Exch.*, 582 P.2d 980, 990, 148 Cal. Rptr. 389, 399 (Cal. 1978). No comparable restrictions limit the damages and fees recoverable under RICO.

Further, the argument of respondent's supporters simply makes no sense. Regardless of insurers' exposure to punitive damages, the *added* exposure to civil remedies under RICO cannot help but increase insurers' costs and aggravate current problems in the insurance markets.

CONCLUSION

The Ninth Circuit's decision, which subjects insurers to greatly expanded liability and costs, is flawed as a matter of law and as a matter of public policy. It threatens a serious disruption of state insurance markets. For these reasons and those advanced by petitioners, this Court should grant the petition for writ of certiorari.

Respectfully submitted October 3, 1995

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